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**Hearing Date: November 10, 2010**
**Hearing Time: 10:00 a.m.**

**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| SECURITIES INVESTOR PROTECTION CORPORATION, | |
| Plaintiff, | SIPA LIQUIDATION |
| | Adv. Pro. No. 08-01789 (BRL) |
| v. | |
| | (Substantively Consolidated) |
| BERNARD L. MADOFF INVESTMENT SECURITIES LLC, | |
| Defendant. | |
| In re: | |
| BERNARD L. MADOFF, | |
| Debtor. | |

**OBJECTION TO TRUSTEE'S MOTION FOR ENTRY OF AN ORDER (I) APPROVING LITIGATION CASE MANAGEMENT PROCEDURES FOR AVOIDANCE ACTIONS AND (II) AMENDING GLOBAL PROTECTIVE ORDER**

Sterling Equities Associates and certain affiliates (the "Sterling Customers") hereby object to the Trustee's Motion for Entry of An Order (I) Approving Litigation Case Management Procedures for Avoidance Actions and (II) Amending Global Protective Order (hereinafter the "Motion") filed October 21, 2010 by the Trustee for the liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS").

The Motion is premature in that it seeks unfairly to restrict the procedural rights of putative defendants—before they know they are defendants—by modifying the applicable procedural rules in litigations in which the Trustee claims he will seek to recover "billions" of dollars. The Motion lacks precedent or foundation.

**BACKGROUND**

1. The Trustee contends that certain BLMIS accountholders "received avoidable transfers of fictitious profits totaling billions of dollars." (Motion ¶ 5.) As a result, the Trustee "expects to commence numerous additional adversary proceedings to avoid and recover such fictitious profits (the 'Avoidance Actions')." (Id. ¶ 7.)

2. On October 21, 2010, the Trustee filed the Motion, seeking authority to modify the Federal Rules of Civil Procedure and the Bankruptcy Rules that would normally govern such adversary proceedings.

3. None of the Avoidance Actions to be governed by the proposed procedures has yet been brought. Putative defendants do not know whether they need to be concerned about the conduct of these incipient cases. But if any customer fails to object, that customer risks being bound by these procedures, which suffer from several infirmities.

**THE AFFECTED PARTIES ARE NOT ON NOTICE**

4. First, specific Federal Rules of Civil Procedure and Bankruptcy Rules govern adversary proceedings, including avoidance litigation. See generally, Fed. R. Bankr. P. 7000 et seq.; Fed. R. Civ. P. 1 et seq.

5. The purpose of these rules is to ensure due process. "The Federal Rules of Civil Procedure are designed to further the due process of law that the Constitution

guarantees." Nelson v. Adams, 529 U.S. 460, 466 (2000). It is fundamental to due process that a party have notice and an opportunity to be heard. See Greene v. Lindsey, 456 U.S. 444, 449 (1982) ("The fundamental requisite of due process of law is the opportunity to be heard.").

6. Parties that have not been served with complaints do not have sufficient notice of how the proposed modifications of the usual rules might affect them. Indeed, the Trustee has cited no case in which a court has substantially limited the application of these rules to cases not yet brought.

7. Consequently, the Motion is premature and violates the due process rights of putative defendants.

**A LEGAL GATING ISSUE SHOULD BE ADDRESSED**

8. Second, the process envisioned by the Trustee imposes unjustified delay and cost upon Madoff victims.

9. Although the Trustee is aware of serious legal challenges to his right to bring any avoidance actions against non-complicit customers, the procedures devised by the Trustee do not allow for resolution of these issues before the expenditure of considerable time and expense on the part of all parties.

10. The pre-trial process envisioned by the Trustee is as follows: the Trustee would file an adversary complaint; a defendant can either answer or otherwise respond, but if a defendant files a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the "issues" raised in the motion and in the complaint are "immediately" referred to mediation; if mediation is not successful (or if the parties mutually agree not to mediate), discovery would ensue (with grave restrictions imposed upon defendants, as

discussed below); after discovery is complete, mediation is mandatory (with no opt out provision); and although it appears that parties can make substantive motions, such as motions for summary judgment, it is unclear whether such motions are permissible before mandatory mediation, and, if they are made, how they are relevant under the proposed procedures.

11. Many customers have asserted in connection with the "Net Equity" litigation now before the Court of Appeals for the Second Circuit that the Trustee's power to assert avoidance claims against customers is extremely limited by various provisions of the Bankruptcy Code, including, but not limited to, Section 546(e). If this argument is sustained, then the procedures sought by the Trustee would likely be unnecessary. As a result, the Avoidance Actions should be stayed, and none of the proposed procedures applied, pending resolution of the issues before the Second Circuit in the "Net Equity" litigation.

12. Further, in its September 16, 2009 Net Equity Scheduling Order setting a procedure for dealing with one set of legal issues, this Court provided that "the Trustee shall confer with counsel regarding the other issues that should be the subject of separate scheduling orders, and shall propose a conference or hearing to set schedules for such issues[.]" (Id. at 6.) The Net Equity Scheduling order contemplates that legal issues such as those relating to the scope of the Trustee's avoidance powers should be addressed like the "net equity" legal issues before any discovery or mediation is undertaken in any of the cases to be brought by the Trustee.

13. Therefore, prudence and respect for judicial economy dictate that, before a thousand motions to dismiss are filed raising many of the same gating legal issues, and

before a thousand adversary cases proceed through full discovery and mediation—all requiring the expenditure of significant time and money by the parties—the question of whether the Trustee can even assert the proposed avoidance claims should be decided. See, e.g., Bouchard Transp. Co. v. Fla. Dep't of Envtl. Prot., 91 F.3d 1445, 1449 (11th Cir. 1996) (finding that the district court abused its discretion by relying on its inherent powers to manage litigation to order the parties to mediate before deciding the threshold issue of whether the defendant was entitled to immunity under the Eleventh Amendment).

**THE PROCEDURAL MODIFICATIONS ARE UNSUPPORTABLE**

14. Third, there is no legal foundation for the Motion.

15. Among other things, the Motion provides for:

a. Immediate referral to mediation if a defendant moves to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), unless the parties mutually agree that mediation will not resolve the issues raised by the defendant's motion or the complaint (Motion ¶ 10.2.D.);

b. Substantive limitations on the scope of discovery as determined unilaterally by the Trustee and specified in the Motion (see id. ¶ 10.4.F.);

c. Time limits to complete discovery that contravene the Federal Rules of Civil Procedure and the Bankruptcy Rules (id. ¶ 10.4.E.);

d. The Trustee himself to be immune from discovery, while making his "financial professionals" available for deposition (id. ¶ 10.4.G. & n.8.);

e. Mandatory mediation at the close of discovery with no ability to opt out of the mediation process (id. ¶ 10.5.C.);

f. No substantive motion practice, other than motions to dismiss, prior to the close of discovery without the Court's prior approval (id. ¶ 10.6.A.); and

g. Non-compliance with the proposed Avoidance Procedures to constitute sanctionable conduct (id. ¶ 10.8.C.).

16. The Trustee asserts that Bankruptcy Rules 7016 and 7026, Bankruptcy Code section 105(a), and "established precedent of this Court" provide a legal foundation for the modifications of the rules requested by the Motion. (Id. ¶ 11; see also id. ¶¶ 12-19.)

17. But Bankruptcy Rules 7016 and 7026 apply only after an adversary proceeding is commenced. See Fed. R. Bankr. P. 7016 (applying Fed. R. Civ. P. 16 to adversary proceedings); Fed. R. Bankr. P. 7026 (applying Fed. R. Civ. P. 26 to adversary proceedings).

18. Bankruptcy Code section 105(a) does not provide a basis for the Trustee to change these rules before commencing such adversary proceedings and does not permit the Trustee to proscribe potential litigants' rights and remedies in contravention of otherwise applicable Bankruptcy and Federal Rules. See, e.g., New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc., 351 F. 3d 86, 92 (2d Cir. 2003) (holding that Section 105(a) can only be exercised within the confines of the Bankruptcy Code); Marc Stuart Goldberg, P.C. v. City of New York (In re Navis Realty), 193 B.R. 998, 1008 (Bankr. S.D.N.Y. 1996) (Section 105(a) is to be used "to supplement other provisions of the Bankruptcy Code"). As the Second Circuit has stated:

> "Section 105(a) of the Bankruptcy Code provides that: "The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title." This power "must and can only be exercised within the confines of the Bankruptcy Code." Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988); see also In re Johns-Manville Corp., 801 F.2d 60, 63 (2d Cir. 1986) ("Section 105(a) . . . does not broaden the bankruptcy court's jurisdiction."). The bankruptcy court's equitable powers cannot be exercised in derogation of other sections of the Bankruptcy Code. In re Morristown & Erie R.R. Co., 885

> F.2d 98, 100 (3d Cir. 1989); In re NWFX, Inc., 864 F.2d 593, 595 (8th Cir. 1989)."

In re Ionosphere Clubs, Inc., 922 F. 2d 984, 995 (2d Cir. 1999).

19. "Established precedent" also fails to support the Motion. In no case cited by the Trustee were rules of procedure substantially modified before affected cases were commenced, except, in one instance, to set a discovery schedule. Modifications that were proposed after the cases were filed were very limited. In no case cited by the Trustee did the court restrict the substantive scope of discovery in any way or mandate mediation at the motion to dismiss stage. Moreover, the Bankruptcy Court's General Order Amending and Restating M-143 and M-211 does not provide for assignment of a matter to mediation before that matter has been commenced.

20. Nor in any case cited by the Trustee has a court given a SIPC or bankruptcy trustee a blanket shield from discovery. The Trustee's proffered reason for immunity—that any information he has is the result of "privileged communications with his attorneys"—cannot be correct. The Trustee is taking the position that billions of dollars in so-called "fictitious profits" are avoidable in this case (see Motion ¶ 5), and defendants are entitled to discover how the Trustee came to that view and how he intends to prove it through facts that are discoverable and not privileged.

**THE PROTECTIVE ORDER SHOULD NOT BE AMENDED IN THE MANNER PROPOSED**

21. Finally, the Motion also seeks to amend the global protective order ("Global Protective Order") entered in the above-referenced proceeding on February 16, 2010 with respect to the treatment of "Confidential Account Information." (See Motion ¶¶ 20-23.) In particular, the Trustee seeks leave from the requirements of the Global Protective

Order so he can publicly file complaints and related exhibits in the Avoidance Actions that contain Confidential Account Information. (Id. ¶ 21.)

22. The Trustee also seeks authorization to make certain Confidential Account Information available to attorneys of record and their retained professionals in the Avoidance Actions during discovery, so long as the attorneys of record and their retained professionals maintain the confidentiality of the information (including not sharing it with their clients), use the information only in the context of the Avoidance Action in which they were retained, and file under seal any pleading or document that includes such confidential information. (Id. ¶ 23.)

23. But the Global Protective Order was put in place to induce customers to provide otherwise confidential information by providing them with protection against public disclosure of that information. Thus, it is the customer and not the Trustee who has the right to determine if, when, and how the customer's confidential information may be disclosed. If the Trustee believes it is necessary to file certain types of Confidential Account Information (or any other protected information) with any Avoidance Action complaints, the Confidential Account Information (or any other protected information) may be filed under seal, as he proposes that Avoidance Action defendants must do. (Compare Motion ¶ 21 with id. ¶ 23.)

**CONCLUSION**

24. For the reasons stated herein, the Motion should be denied.

Dated: New York, New York
November 4, 2010

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